IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.1006 OF 2000

The Commissioner of Income-tax,
Mumbai City - II, Mumbai. ..Appellant.

V/s.

ACE Builders Pvt.Ltd.
Meher House 1st Floor, 15
Cawasji Patel Street, Fort,
Muambai - 400 001 ..Respondent.

Mr.R.V.Desai, senior Advocate with Mrs.S.V.Bharucha for the appellant.

Mr.S.N.Inamdar, senior Advocate for the respondent.

CORAM : S.RADHAKRISHNAN AND J.P.DEVADHAR, JJ.

DATED : 7TH MARCH, 2005.

JUDGMENT (PER J.P. DEVADHAR, J.)

1. This appeal filed under section 260A of the Income Tax Act, 1961 ('I.T. Act' for short) by the Commissioner of Income Tax, Mumbai City-II, Mumbai was admitted on the following substantial question of law :-

" Whether on the facts and in the circumstances of the case, the Tribunal was right in law in

holding that the assessee is entitled to deduction under section 54E in respect of the capital gain arising on the transfer of a capital asset on which depreciation has been allowed and which is deemed as short term capital gain under section 50 of the Income-tax Act, 1961"

2. The assessment year relevant herein is AY 1992-93.

3. The respondent [hereinafter referred to as 'the assessee'] is a private limited company. The assessee was a partner in a firm called M/s.D.Manekji and Associates. The said firm was dissolved in the year 1984 and the assessee was allotted a flat against the balance standing to its credit in the capital account with the firm. The assessee had shown the said flat as capital asset in its books of account and depreciation in respect thereto has been claimed from year to year. The cost of the gross block was Rs.1,87,390/- and depreciation upto 31/3/1991 was Rs.44,875/-. The resulting written down value as on 31/3/1991 was Rs.1,42,515/-. In the previous year relevant to the assessment year 1992-93, the assessee sold the said flat for a sum of Rs.5,20,000/-. The net sale proceeds were invested in the units "UTI capital gains scheme" with a view to claim deductions under section 54E of the I.T. Act and accordingly, in the return of income filed for the assessment year in question, the assessee declared 'Nil' income under the head 'income from capital

gains’.

4. The assessing officer, however, in his assessment order, held that since the entire block of building had ceased to exist on account of sale of the flat during the year, the written down value of the asset was liable to be taken as cost of acquisition under section 50(2) of the I.T. Act. The assessing officer further held that as the assessee had availed depreciation on the transferred long term capital asset, the capital gain arising on transfer of such a long term capital asset was liable to be treated under section 50 of the I.T.Act, as capital gain arising out of a short term capital asset and since the benefit under section 54E of the I.T.Act is available only to the capital gain arising on transfer of a long term capital asset, the assessee is not entitled to the exemption under section 54E of the I.T.Act. In other words, the assessing officer held that in view of section 50 of the I.T.Act, the transfer of a long term capital asset on which depreciation has been allowed was liable to be treated as capital gain arising out of a sale of a short term capital asset and, therefore, the benefit under section 54E of the I.T. Act was not available to the assessee.

5. On appeal filed by the assessee, the

Commissioner of Income Tax (A) held that section 50 of the I.T. Act being a special provision for computation of capital gains in the case of depreciable asset, the assessing officer has rightly computed capital gains under section 50(2) of the I.T. Act and in view of the deeming provisions, the capital gains arising in the present case had to be treated as capital gain arising from the transfer of a short term capital asset and, therefore, not exempted under section 54E of the I.T. Act.

6. On further appeal filed by the assessee, the Tribunal by the impugned order held that the deeming fiction attached to section 50 of the I.T. Act has to be restricted only for the method of computing the capital gain and cannot be read into while considering the case for non changeability of capital gain. Accordingly, the Tribunal held that the assessee is entitled to the exemption under section 54E of the I.T. Act. Hence this appeal is filed by the revenue.

7. Mr.R.V.Desai, learned senior advocate appearing on behalf of the revenue submitted that section 50 of the I.T. Act introduced with effect from 1/4/1988 is a special provision for computation of capital gains in the case of depreciable assets. He submitted that the capital gains derived from the sale of depreciable assets are to

be computed in the manner provided in section 50 of the I.T.Act. He submitted that section 50(2) of the I.T. Act clearly provides that the capital gain arising or accruing as a result of transfer of a depreciable long term capital asset which forms a part of the block of asset shall be deemed to be a capital gain arising or accruing from the transfer of short term capital asset and, therefore, benefit under section 54E which is restricted to capital gain arising or accruing on sale of a long term capital asset is not available on such capital gains.

8. Mr.Desai further submitted that the object of introducing section 50 in the I.T. Act as explained by the Madras High Court in the case of **M.Raghavan V/s. Asstt. Commissioner of Income Tax [266 I.T.R. 145]** is not to allow multiple benefits to the assessee selling a depreciable asset. He submitted that in the present case, the capital asset sold was forming part of the block of asset and admittedly depreciation was availed on the said capital asset. Therefore, the capital gain arising on such asset had to be computed under section 50 and once section 50 is applicable, in view of the fiction created therein, the capital gain is liable to be treated as short term capital gain and consequently, benefit under section 54E which is restricted to long term capital gain would not be available. He submitted that the decision of the

Gauhati High Court in the case of **C.I.T. V/s. Assam Petroleum Industries (P.) Ltd. [262 I.T.R. 587]** which is in favour of the assessee is not in conformity with the aim and object of section 50 of the I.T.Act. He submitted that by section 50 of the I.T.Act, the legislature has converted a long term capital asset on which depreciation has been availed into a short term capital asset and, therefore, the benefit under section 54E which is available only to the capital gains arising on sale or transfer of a long term capital asset is not available to the assessee. Accordingly, Mr.Desai submitted that the substantial question of law raised in the appeal be answered in favour of the revenue.

9. Mr.S.N.Inamdar, learned counsel appearing on behalf of the assessee submitted that section 54E of the I.T. Act neither makes a distinction between 'Depreciable Asset' and 'Non Depreciable Asset'. He submitted that section 54E is not concerned with the computation of capital gains. The said exemption under section 54E of the I.T. Act is granted if the net consideration received on sale of a long term capital asset is invested in specified securities within the prescribed time, irrespective of the mode or manner of computing it. Accordingly, Mr.Inamdar submitted that irrespective of the fact that the capital gain arising on sale of long term

capital asset on which depreciation has been claimed is computed under section 50 of the I.T. Act, the amounts so computed is entitled to the benefit under section 54E of the I.T. Act on fulfilment of the conditions set out therein. In the present case, since the assessee had complied with the conditions set out in section 54E of the I.T. Act, the assessee cannot be denied the benefit under the said section.

10. Mr.Inamdar submitted that the capital gain arising on transfer of a capital asset is computed under section 48 of the I.T.Act by deducting from the full value of consideration, the actual costs of the capital asset and any expenditure incurred in connection with such transfer. Section 49 of the I.T. Act allows cost of the previous owner [and consequently market value as on 1/4/1981 if the capital asset was held by the previous owner before that date] to be substituted for the actual cost. Section 50 of the I.T. Act prescribes a modification to the provisions to section 48 which granted a standard deduction as well as a further deduction in respect of long term capital gains upto AY 1992-93. From AY 1993-94 onwards, benefit of indexation is also granted under section 48 of the I.T. Act. Thus, the benefits available under sections 48 and 49 are curtailed or modified by section 50 of I.T. Act which prescribes a

different mode and manner of computing the capital gains in respect of the asset on which depreciation is allowed.

11. Mr.Inamdar further submitted that by creating a fiction that "income received or accruing as a result of such transfer or transfers shall be deemed to be capital gains arising from transfer of short term capital assets" in section 50 of the I.T. Act, the legislature made it clear that the purpose of the fiction is merely to deem gains as short term capital gains and not to deem the asset itself as short term capital asset. In this connection, Mr.Inamdar strongly relied upon the decision of the Gauhati High Court in the case of **Commissioner of Income-Tax V/s. Assam Petroleum Industries (P.) Ltd. [262 I.T.R. 587]**.

12. Mr.Inamdar further submitted that section 50 of the I.T.Act expressly provides that the modifications prescribed therein are firstly, restricted only to computation of capital gains and secondly, limited only to sections 48 & 49 of the I.T.Act. Accordingly, he submitted that the fiction created under section 50 of the I.T.Act is limited to sections 48 & 49 of the I.T.Act and cannot be extended to section 54E of the I.T.Act.

13. Mr.Inamdar further submitted that the scope and

effect of section 50 of the I.T.Act (as substituted with effect from 1/4/1988) is very clearly brought out in para 6.4 and 6.5 of CBDT Circular No.469 dated 23rd September, 1986 wherein it is clearly stated that section 50 prescribes the manner in which the cost of acquisition in the case of depreciable asset may be computed for the purpose of determining the capital gains and that the income from such transfer shall be deemed to be short term capital gains. Accordingly, Mr.Inamdar submitted that section 50 does not convert long term capital asset into a short term capital asset as contended by the revenue.

14. Mr.Inamdar further submitted that in the present case, there is no dispute that the asset transferred is a long term capital asset and that if the gain is to be taxed, it will be taxed as short term capital gains but if the assessee invests the gain in any specified securities then, the assessee is exempt from paying the capital gains tax. He submitted that section 54E of the I.T. Act should not be allowed to be clouded by the wording or fiction in section 50 which is employed or created for a limited purpose. Relying upon the decision of the Apex Court in the case of Commissioner of **Income Tax V/s. Canara Workshop Ltd. [161 I.T.R. 320]**, Mr.Inamdar submitted that section 54E is a incentive and beneficial provision to encourage investment in desired channels.

Accordingly, the counsel submitted that the question raised in the appeal be answered in favour of the assessee and against the revenue.

15. Before dealing with the rival contentions, it would be appropriate to refer to the relevant provisions of the Income Tax Act which deal with the taxability of the capital gains.

16. Section 2 of the I.T.Act defines various terms used in the I.T.Act. Section 2(14) defines "capital asset", section 2(29A) defines "long term capital asset" and section 2(29B) defines "long term capital gain". Similarly section 2(42A) defines "short term capital asset" and section 2(42B) defines "short term capital gain". Thus, each of the above terms used in various provisions of the I.T.Act have distinct meaning as defined under the Act.

17. Section 45 of the I.T.Act (as it stood at the relevant time) states that any profits or gains arising from the transfer of a capital asset effected in the previous year, shall save as otherwise provided in sections 54 54B, 54D and 54E, be chargeable to income tax under the head "capital gains" and shall be deemed to be the income of the previous year in which the transfer took

place.

18. Section 48 (1)(a) of the I.T.Act (as it stood at the relevant time) states that while computing the income under the head "capital gains" the expenditure incurred wholly and exclusively in connection with such transfer and the cost of acquisition of the asset and the cost of any improvement thereto shall be deducted from the value of consideration. Section 48 (1)(b) provides that where the capital gain arises from the transfer of a long term capital asset, then, there shall be further deductions as specified in sub-section (2) of section 48 of the I.T.Act.

19. Section 49 of the I.T.Act provides that in certain cases where the asset is acquired without incurring any cost, the cost of acquisition of such asset shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.

20. Section 50 is a special provisions for computing the capital gains in the case of depreciable assets and the same being relevant for the purpose herein, is quoted hereinbelow :-

" **Special provision for computation of capital gains in case of depreciable assets.**

50. Notwithstanding anything contained in clause (42A) of section 2, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed under this Act or under the Indian Income-tax Act, 1922 (11 of 1992), the provisions of sections 48 and 49 shall be subject to the following modifications :-

(1) where the full value of the consideration received or accruing as a result of the transfer of the asset together with the full value of such consideration received or accruing as a result of the transfer of any other capital asset falling within the block of the assets during the previous year, exceeds the aggregate of the following amounts, namely :-

(i) expenditure incurred wholly and exclusively in connection with such transfer or transfers;

(ii) the written down value of the block of assets at the beginning of the previous year; and

(iii) the actual cost of any asset falling within the block of assets acquired during the previous year,

such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets;

(2) where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as

> increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets. "

21. On perusal of the aforesaid provisions, it is seen that Section 45 is a charging section and sections 48 and 49 are the machinery sections for computation of capital gains. However, Section 50 carves out an exception in respect of depreciable assets and provides that where depreciation has been claimed and allowed on the asset, then, the computation of capital gain on transfer of such asset under sections 48 and 49 shall be as modified under Section 50. In other words, Section 50 provides a different method for computation of capital gain in the case of capital assets on which depreciation has been allowed.

22. Under the machinery sections the capital gains are computed by deducting from the consideration received on transfer of a capital asset, the cost of acquisition, the cost of improvement and the expenditure incurred in connection with the transfer. The meaning of the expressions ‘cost of improvement’ and ‘cost of acquisition’ used in sections 48 and 49 are given in section 55. As the depreciable capital assets have also

availed depreciation allowance under section 32, section 50 provides for a special procedure for computation of capital gains in the case of depreciable assets. Section 50(1) deals with the cases where any block of depreciable assets do not cease to exist on account of transfer and Section 50(2) deals with cases where the block of depreciable assets cease to exist in that block on account of transfer during the previous year. In the present case, on transfer of depreciable capital asset the entire block of assets has ceased to exist and, therefore, Section 50(2) is attracted. The effect of Section 50(2) is that where the consideration received on transfer of all the depreciable assets in the block exceeds the written down value of the block, then the excess is taxable as a deemed short term capital gains. In other words, even though the entire block of assets transferred are long term capital assets and the consideration received on such transfer exceeds the written down value, the said excess is liable to be treated as capital gain arising out of a short term capital asset and taxed accordingly.

23. The question required to be considered in the present case is, whether the deeming fiction created under Section 50 is restricted to section 50 only or is it applicable to section 54E of the Income Tax Act as well ?

In other words, the question is, where the long term capital gain arises on transfer of a depreciable long term capital asset, whether the assessee can be denied exemption under section 54E merely because, section 50 provides that the computation of such capital gains should be done as if arising from the transfer of short term capital asset ?

24. Section 54E of the Income Tax Act grants exemption from payment of capital gains tax, where the whole or part of the net consideration received from the transfer of a long term capital asset is invested or deposited in a specified asset within a period of six months after the date of such transfer. In the present case it is not in dispute that the assessee fulfills all the conditions set out in section 54E to avail exemption, but the exemption is sought to be denied in view of fiction created under section 50.

25. In our opinion, the assessee cannot be denied exemption under section 54E, because, firstly, there is nothing in section 50 to suggest that the fiction created in Section 50 is not only restricted to sections 48 and 49 but also applies to other provisions. On the contrary, Section 50 makes it explicitly clear that the deemed fiction created in sub-section (1) & (2) of section 50 is

restricted only to the mode of computation of capital gains contained in Section 48 and 49. Secondly, it is well established in law that a fiction created by the legislature has to be confined to the purpose for which it is created. In this connection, we may refer to the decision of the Apex Court in the case of **State Bank of India V/s. D. Hanumantha Rao** reported in **1998 (6) S.C.C.183**. In that case, the Service Rules framed by the bank provided for granting extention of service to those appointed prior to 19/7/1969. The respondent therein who had joined the bank on 1/7/1972 claimed extention of service because he was deemed to be appointed in the bank with effect from 26/10/1965 for the purpose of seniority, pay and pension on account of his past service in the army as Short Service Commissioned Officer. In that context, the Apex Court has held that the legal fiction created for the limited purpose of seniority, pay and pension cannot be extended for other purposes. Applying the ratio of the said Judgment, we are of the opinion, that the fiction created under section 50 is confined to the computation of capital gains only and cannot be extended beyond that. Thirdly, section 54E does not make any distinction between depreciable asset and non depreciable asset and, therefore, the exemption available to the depreciable asset under section 54E cannot be denied by referring to the fiction created under section 50. Section 54E

specifically provides that where capital gain arising on transfer of a long term capital asset is invested or deposited (whole or any part of the net consideration) in the specified assets, the assessee shall not be charged to capital gains. Therefore, the exemption under section 54E of the I.T.Act cannot be denied to the assessee on account of the fiction created in section 50.

26. It is true that section 50 is enacted with the object of denying multiple benefits to the owners of depreciable assets. However, that restriction is limited to the computation of capital gains and not to the exemption provisions. In other words, where the long term capital asset has availed depreciation, then the capital gain has to be computed in the manner prescribed under Section 50 and the capital gains tax will be charged as if such capital gain has arisen out of a short term capital asset but if such capital gain is invested in the manner prescribed in Section 54E, then the capital gain shall not be charged under Section 45 of the Income Tax Act. To put it simply, the benefit of section 54E will be available to the assessee irrespective of the fact that the computation of capital gains is done either under sections 48 & 49 or under section 50. The contention of the revenue that by amendment to section 50 the long term capital asset has been converted into to short term capital asset is also

without any merit. As stated hereinabove, the legal fiction created by the statute is to deem the capital gain as short term capital gain and not to deem the asset as short term capital asset. Therefore, it cannot be said that section 50 converts long term capital asset into a short term capital asset.

27. For all the aforesaid reasons, we concur with the decision of the Gauhati High Court in the case of C.I.T. V/s. Assam Petroleum Industries (supra) and hold that the Tribunal was justified in allowing the benefit of exemption under section 54E of the I.T.Act to the assessee in respect of the capital gains arising on the transfer of a capital asset on which depreciation has been allowed.

28. Accordingly, the appeal fails. The substantial question of law raised by the revenue is answered in the affirmative i.e. in favour of the assessee and against the revenue.

29. Appeal is disposed of in the above terms with no order as to costs.

(S.RADHAKRISHNAN, J.)

(J.P. DEVADHAR, J.)